WASHINGTON STATE LIQUOR CONTROL BOARD

Issue Paper

Brief Description of Topic: Tied House Statute Concept for Change – Financial Interest/Ownership and Money/Money's Worth

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INTRODUCTION

This paper is intended to provide a summary of comments received from stakeholders and other interested parties regarding a concept for change presented to the Tied House Review Team on December 6, 2007.

DESCRIPTION OF ISSUE

The Tied House Statute (RCW 66.28.010) prohibits manufacturers and distributors from having any ownership interest in a retail establishment. In addition, it is prohibited for a manufacturer, distributor, or importer to give money, or like items of value, to a retailer. Since the statute was created in 1935, over 60 exceptions have been approved by the Legislature. With the various exceptions, the statute is difficult to interpret and enforce. As one stakeholder stated *"it has been stated that the system is too complex but it is a complex business environment and a complex mission to regulate alcohol."*

BACKGROUND

The current Three-Tier system and "Tied House" laws were introduced after the repeal of Prohibition to avoid an imbalance between manufacturers and retailers and to limit activities and relationships between the tiers. Tied House regulations require the financial separation (or independence) of manufacturers and distributors from retailers. Manufacturers could no longer be "tied" to the retailer ("house" or tavern) through ownership or other financial interests or create incentives that could also exert undue influence on retailers and ultimately, on consumers.

In March 2006, Governor Gregoire signed Second Substitute Senate Bill (2SSB) 6823. This bill directed the Liquor Control Board (LCB) to convene a broad-based Task Force whose charge was to conduct a comprehensive review of the current regulatory system controlling the sale and distribution of beer and wine in Washington State. The Task Force was asked to recommend what, if any, changes should be made to the current regulatory system.

The Task Force consisted of 20 diverse stakeholders, including legislators, and a non-voting Chair. Most Task Force members generally agreed that the current system of regulating the distribution and sale of beer and wine could benefit from some changes. They recommended continuing the state's current approach of adopting specific exceptions to the prohibition against allowing financial interest and providing money's worth to retailers, and directed the LCB to convene a workgroup to evaluate the Tied House Statute. Their specific recommendations were as follows.

> *"Recommendation #2: The Task Force recommends continuing the state's current approach of adopting specific exceptions to the prohibitions against providing money's worth to retailers, and directs the LCB to work with stakeholders to re-examine current exceptions and develop a comprehensive list of proposed exceptions for legislative consideration. When developing the list of recommended exceptions, the LCB should consider:*
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> - *Industry business needs,*
> - *Customer benefits,*
> - *Whether it creates an unwanted inducement for retailers,*
> - *The potential for increased misuse of alcohol, and*
> - *Enforcement resources."*

> *"Recommendation #3: The Task Force encourages the liberalization of the Tied House ownership restrictions, and recommends that the Legislature work with the LCB to arrive at a workable solution."*

In January 2007, a new workgroup was created (Tied House Review Team), comprised of LCB staff and stakeholders. To allow continuity many members also served on the Three Tier Task Force. Their objective was to review the ownership restrictions, financial interest, and money's worth within the Tied House Statute to identify options and impacts for change. Six meetings were conducted between January and June 2007. The final meeting with the team was held December 6, 2007.

PROCESS

In January 2007, the LCB convened an advisory team of stakeholders and LCB staff to review the Tied House Statute. The team was called the Tied House Review Team and they used material collected and developed by the Three Tier Task Force to create a common understanding of the purpose of the Tied House Statute.

An internal LCB planning team was created comprised of Randy Reynolds (Non-Retail), Karen McCall (Licensing/Legislative/Policy), Pam Madson (Rules), Jeanne Reschan (Non-Retail Enforcement), Steve Burnell (Wine Marketing), and Mona Moberg (Project Manager). The planning team's purpose was to develop a concept for change to present to the Tied House Review team.

The planning team dedicated over 350 staff hours to review research data, Three-Tier Task Force information, various state statutes, business practices from other states, comments/suggestions made by stakeholders, and federal laws. Input from various Stakeholders offered a variety of options:

- Maintain status quo.
- Relax financial interest restrictions.
- Adopt federal guidelines (TTB) and regulate outcomes.

- Grant LCB discretion to grant money's worth exceptions.
- Remove restrictions on money's worth (LCB define prohibitive practices) so everything is allowed.

The planning team used four goals as the basis to build the concept for change. The goals were:

- Prevent misuse and over-consumption
- Prevent youth access to alcohol through education and enforcement
- Prevent coercion between the tiers
- Promote efficient collection of taxes

Based on these four goals, the planning team developed three possible models for changing how the LCB regulates financial interest and money's worth practices. As part of their work, they looked closely at current tied house restrictions to understand the policy basis for exceptions. The first model offered some change to the current system such as allowing indirect interest/ownership but would still prohibit most money's worth activities. Dollar values would be assigned to the amount of money's worth allowed between manufacturers, distributors, and retailers. The second model offered more flexibility to allow both partial and full interest/ownership between the tiers but certain criteria would need to be met to prove there was no threat to retailer independence. The second model allowed more money's worth activities but activities would be evaluated against specific criteria focused on protecting the public.

The third model was created to allow the LCB to consider in case the court litigated regulations were removed. The planning team explored a different concept that would be a departure from the LCB's current practice of prohibiting activities and creating exceptions as needs were identified. The planning team developed a model that started with a "clean slate," assumed current exceptions were "not sacred," and that maintaining a level playing field would not be a guiding principle.

CONCEPT FOR CHANGE

A concept for change was presented to the Tied House Review team on December 6, 2007. The goal was to gather their feedback to learn how changing the tied house statute to be more "open" might harm the public. The concept was also mailed to over 80 different stakeholders and interested parties to allow further written comment to be considered. The concept covered three general areas.

Board Authority The Legislature would grant the Board authority to prohibit financial interest and money's worth practices based on guidance from the Legislature. Staff would review the request and provide supporting information to help the Board make the decision. Criteria would be created to allow more consistency in decisions and more flexibility in the timing of decisions (could occur year-round).

Current Practice	Stakeholders present requests for exceptions to the Legislature during session.
Financial Interest	Allow full and partial financial interest or ownership of a retail establishment by a manufacturer, distributor, or importer.
Current Practice	No financial interest or ownership by a manufacturer, distributor, or importer is allowed. Exceptions have been allowed by the Legislature. These exceptions now allow Washington wineries and breweries to serve as all three tiers.
Money's Worth	Money's Worth is allowed between a manufacturer, distributor, or importer and retailer except any tied house activity that impacts public safety. Prohibited activities are defined by the LCB.
Current Practice	Money's Worth is prohibited between a manufacturer, distributor, or importer and retailer. Exceptions have been created to allow things of nominal value, advertising activities, and certain labor functions.

STAKEHOLDER COMMENTS

Stakeholders provided extensive written comments and examples of what results could occur if this concept were implemented. Comments were received from 52 individuals representing manufacturers, distributors, retailers, prevention community, associations representing individual tiers, and experts working in the alcohol regulation field. Sixty three percent of the comments were from Washington distributors who had major concerns about changing the system. Appendix A is a list of all the individuals who submitted comments.

Only five of the respondents supported the overall concept for changing the tied house statute. In general, respondents did not feel that significant change was needed and that the concept would allow dramatic changes with unintended consequences. There was also comment that indicated concern that the concept did not reflect all the recommendations from the Three-Tier Task Force such as "to promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption." Feedback on the three components of the concept for change was as follows.

Board Authority
While there were not a lot of specific comments on this topic, the majority of respondents who did comment felt that the Board should have broad rule-making authority and that the current legislative process is effective.

> *"…we strongly believe that the Liquor Control Board should have broad rule-making authority when it comes to protecting public safety. However, that authority should be more limited in situations pertaining to market access and market forces." (Washington Food Industry)*

> *"…our members believe that the Liquor Control Board should have some rule-making authority….In an effort to address this, any delegation of authority to the Board should probably be limited in scope at first—maybe to licensing, money/money's worth and/or tied house laws." (Washington Restaurant Association)*

> *"In Washington State we have regulations that work, and a process of practical change via intelligent conversation with the legislature that also works." (Washington Craft Brewery)*

Financial Interest/Partial Ownership
The general theme from stakeholders was that financial interest should remain separate between the tiers. In addition, there was concern that TTB does not have adequate staffing to monitor and enforce activities between manufacturers and distributors.

> *"…there would be a conflict between state and federal law as it relates to partial ownership of a retailer by an industry member." (TTB)*

> *"…big distributors within the state could establish retail outlets or purchase existing retail outlets….and have a negative impact on established small retailers, distributors, and grocery chains. Small retailers may not be able to shift their business strategy quickly enough to survive the change." (Beer/Wine Specialty Shop)*

> *"The distinction between cooperative business practices and financial interests that can result in the manufacturer exercising undo control over retail business can be difficult to determine….Blanket regulations cannot cover every potential manufacturer/retail relationship that will evolve in the future." (Washington State Governor's Council on Substance Abuse)*

> *"…overlapping ownership and other financial relationships between suppliers or distributors and retailers….would make coercion a fact of life in the industry because it would put large retailers in position to demand lower prices…." (Washington Beer and Wine Wholesalers)*

A few minority opinions suggested that the LCB should adopt the concept.

> *"The changes outlined by the Liquor Board are bold and dramatic. If adopted, they will change the way wine is made and sold in Washington*

State. In sum, Washington will become the best state in the nation to make, distribute, sell and enjoy wine." (Washington Winery)

"We encourage the Board to proceed expeditiously with implementing the Concept." (Large Retailer)

Money/Money's Worth

The general theme across the tiers was that the Liquor Control Board should continue to prohibit and enforce exchange of money's worth between a manufacturer, distributor, importer, and a retailer. Many stakeholders felt that what has been allowed under current exceptions should continue to be allowed.

> *"I strongly oppose manufacturer payment to the retailer for exclusive brand advertisement. This change would discourage competition and encourage development of monopolies, eroding the separate (separation) of the tiers." (Washington State Governor's Council on Substance Abuse)*

> *"…allowing all activities….with emphasis on controls in areas that negatively impact public safety…will create a more enforceable system and result in greater efficiencies in the collection of taxes. What was allowed under the old system [should] be allowed under any new system." (Washington Restaurant Association)*

> *"…oppose requirement of manufacturers to pay all or part of cooperative product advertising." (California Wine Institute)*

> *"These changes will reduce choice for the consumer….The long-term for the consumer will be higher prices to compensate for the possible slotting allowances and other bribes to retailers." (Washington Brewers Guild)*

> *"If slotting fees or exchanges of more than "money's worth" are allowed, the effect would squeeze many companies out of business." (Washington Distributor)*

> *"Using Alaska as an example, where elements of the "money's worth" concept has run rampant for many years, you will find inflated retail prices, lack of consumer choice, and a market that is primarily dominated by a handful of gigantic retailers…." (Washington Distributor)*

A few minority opinions supported the concept.

> *"We believe that the movement toward allowing all activities – even if currently exempted and putting renewed emphasis on controls in areas that negatively impact public safety…will create a more enforceable system and result in greater efficiencies in the collection of taxes." (Washington Food Industry)*

> *"…the Liquor Board would not longer be an "economic policeman" limiting the operation of the free market. Instead it would focus on its prime missions of protecting public safety and collection of taxes…." (Washington Winery)*

NEXT STEPS

The Board will recommend the Legislature conduct an interim study in 2008 using the information collected by the Three-Tier Task Force and the Tied House Review Team.

ATTACHMENT

- Appendix A – List of respondents to concept for change.